

1907

# THE SEPARATION OF STATE AND LOCAL REVENUES

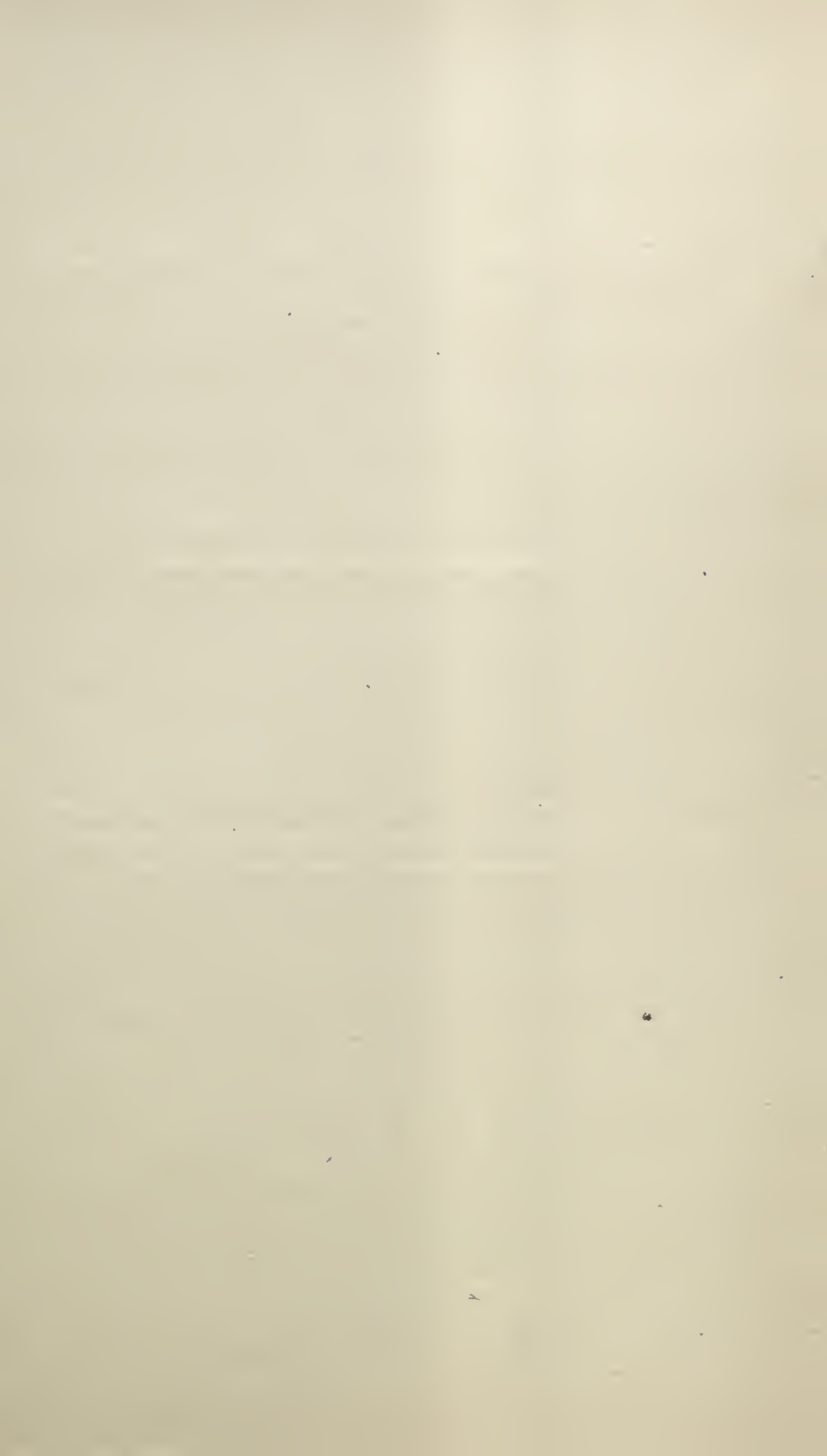
BY

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REPRINTED FROM THE ADDRESSES AND PROCEEDINGS OF THE  
NATIONAL CONFERENCE ON STATE AND LOCAL TAXATION  
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NATIONAL TAX ASSOCIATION  
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# THE SEPARATION OF STATE AND LOCAL REVENUES

BY PROFESSOR EDWIN R. A. SELIGMAN

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## I

THE discontent with the conditions of American taxation is growing apace. The reason is not far to seek. On the one hand, the development of industrial democracy is everywhere creating greater demands upon the public purse for a collective action which shall be in the interests of the entire community; on the other hand, the growth of prosperity and the transition from more primitive economic conditions to those of a complex industrial society are rendering more and more inadequate the fiscal basis and the fiscal machinery which have been bequeathed to us by our ancestors. Thus at both ends the pressure is felt. The fiscal needs are multiplied and the fiscal machinery is getting out of gear. Expenditures are growing, and the old forms of revenue are no longer suitable. Hence the pressure of public needs upon public resources. And since these public needs are augmenting most rapidly in the domain of local rather than of national government, it is primarily questions of state and local revenues that are becoming increasingly embarrassing.

It would be a mistake, however, to suppose that the public resources are in themselves inadequate. The fault does not lie with the social income. National prosperity is great and growing, and the increase of wealth and of social income is proceeding unchecked. Were our state and local resources marshaled and organized for fiscal purposes as is done by the national government, the embarrassment would soon vanish. We all know that in normal times there has never been the slightest difficulty in securing a revenue for national purposes which should be, not only abundant, but on the whole satis-

factory to the community. We know equally well, however, that what has been so successfully done by the national government is very imperfectly accomplished by our state and local governments. The wealth is there, the resources are there, but the method of tapping the resources has become unsatisfactory, lopsided and unequal. What is needed is a readjustment of the system to make it fit modern necessities.

In an empire like the United States the problem will naturally assume a somewhat different form in various sections. Finance and politics are but the ultimate expression of economic forces and relations, and the economic conditions vary widely throughout our country. The transition from the frontier life and the activity of a purely agricultural community to the conditions of a highly developed and complex industrial community has made far more progress in some sections than in others, and to the extent that this transition has only begun, the older methods possess a certain measure of validity. What is good for New York is not necessarily good for Mississippi, nor again for Utah. But notwithstanding this diversity of economic conditions, there are certain phenomena which are common to all. The large corporate agencies of transportation are found throughout the country. Some of the great trusts are selling their products in the little hamlets as well as in the important commercial centers. Certain defects in our fiscal system are therefore being recognized as common to the whole country, and with the development of more homogeneous economic conditions this is bound to be increasingly true in the future. We have tax commissions wrestling with very much the same problems, not only in Massachusetts and New York, but in Minnesota and Wisconsin; not only in Louisiana, but on the Pacific slope.

What, then, are the chief difficulties in our tax system which are coming more and more to be recognized everywhere throughout the length and breadth of the land. I should sum them up under eight heads.

First and foremost is the breakdown of the general property tax, which is almost everywhere still the chief reliance of state and local government. The general property tax works well only amid most primitive economic conditions for which alone

it was calculated. Almost everywhere, for reasons which it is unnecessary here to recapitulate, and which it is utterly impossible to prevent, personalty is slipping from under. The administration of the general property tax is everywhere attended with increasing difficulty, and in our large industrial centers it has become, to use the words of a recent tax report, "a howling farce." Everywhere, north and south, east and west, although in varying degree, comes the cry that the attempt to enforce the general property tax, whether by listing bills or tax ferrets, by oaths or by inquisitors, is doing much to force upon the average citizen habits of falsehood and corruption.

Second, a growing lack of equality in tax burdens, not only as between classes in the community, but as between individuals of the same class. Where land, for instance, is assessed at 20 per cent of its value in certain counties, and at 80 per cent or 100 per cent in other counties, it is obvious that the contribution to the state tax is grossly unequal and unfair.

Third, the application to general purposes of what was intended to be only a local revenue. All direct taxation was originally local in character, and the assessment of property for local taxation was at the outset a comparatively simple matter. When the need for state revenues made itself felt, it was obviously expedient to tack on to this local taxation a quota for general purposes. But with the great development of state functions, and with the breakdown of the local barriers of commerce and industry, what was originally equal soon turned into inequality, and the attempt to fetter interlocal or even interstate business conditions by the bonds of purely local assessment has proved to be a fruitful source of difficulty.

Fourth, the failure to make modern corporations bear their fair share of taxation. The corporation is a growth of the last half century. It was unknown when the present framework of our tax system was established. The attempt to force the new wine into the old bottles is not only spoiling the wine, but cracking the bottles.

Fifth, the failure to secure adequate compensation from individuals and corporations alike for the franchises and privileges that are granted by the community. An earnest effort is being made at present throughout the length and breadth of

the land to repair this defect. But with the historic system as it has come down to us in this country of estimating wealth in terms of property rather than, as abroad, in terms of income, we have been plunged into the vortex of the assessment of franchises, and have thus been compelled to attack a problem which does not even exist in other parts of the world.

Sixth, the undue burden cast upon the farmer. Practically, this is the problem of taxation in many of our rural districts and in all agricultural communities where the failure of an adequate revenue system and of the readjustment of social resources makes it impossible to secure good schools or fairly decent roads without overburdening what is, after all, the chief source of American prosperity.

Seventh, the interference with business, due to the partial and spasmodic enforcement of antiquated laws. Witness the attempt in some States suddenly to levy the mortgage tax, as recently in New York, where the entire building industry was thrown into confusion; or the attempt in other States to enforce now this and now that kind of property tax on businesses which led to a change in the location of the business rather than to any increase of revenue. The harassing of the individual business or the fear of harassment is becoming less and less defensible in the delicately adjusted mechanism of modern business society. Over a century ago Alexander Hamilton, in his famous report on manufactures, stated this golden maxim: "All taxes which proceed according to the amount of capital supposed to be employed in a business are inevitably hurtful to industry and are particularly inimical to the success of manufacturing industry and ought carefully to be avoided by a government which desires to promote it. It is in vain that the evil may be endeavored to be mitigated by leaving it, in the first instance, in the option of the party to be taxed to declare the amount of his capital or profits."

Eighth, the failure to make great wealth contribute its due share. In former times, where property was fairly equally distributed and conditions simple, inequalities in tax burdens were slight and unperceived. Before the huge aggregations of modern wealth, the crude tax machinery of earlier days stands impotent. And yet we hug ourselves with the delusion that



all that is necessary is to patch up the old machinery, whereas what is really needed is to throw the old machinery on the scrap heap and to utilize entirely new and modern instruments and processes.

## II

We must recognize the fact, however, that revolutions of this kind occur but seldom. The only method of achieving substantial progress in society is, after all, by attempting to go forward step by step. But however slow the change, it is imperative that the goal be kept clearly in mind if there is to be any progress at all. If we move step by step, it is highly important that each step be a forward, and not a retrograde, one. Now the starting point from which progress of all kinds must set out is at the present time in the United States the abandonment of the use of the identical revenue for state and local purposes. Whatever other reforms are needed, and they are many, no lasting progress can be made unless we take this preliminary step. It is for this reason that I have ventured to put in the foreground of discussion the problem of the separation of state and local revenues.

The utilization of the same sources for both purposes is, as we have seen, a natural development, at least in Anglo-Saxon communities where the spirit of self-government has always been strong, and where the local unit has been the cell that has grown through accretion into a mighty nation. Yet the employment of the identical sources of revenue for state and local purposes has not only engendered all the difficulties which have been adverted to above, but has succeeded in confusing the issue, and in rendering almost impossible a satisfactory solution of the problem. Where each local community finds that its interests are in some unaccountable way bound up with those of other communities, the tendency is to induce an unwillingness to experiment with any changes, no matter how necessary, which through the influence of these common interests may perhaps react disadvantageously upon the interests of the particular community. The result is the breeding of mutual suspicion and, what is still worse, of lethargy. Just as no single individual can be expected to submit an accurate



list of his taxable property when he is absolutely sure that his neighbors are all successfully withholding their own, so no community will be willing to make any change in methods, the result of which would, in all probability, only be to increase its common burdens. The separation of state and local revenues is therefore a matter of vital importance in the American commonwealths of to-day, not so much because it forms in itself any solution of the problem, but because it is the indispensable initial step to any substantial progress. The separation of state and local revenues is not a cure, but it alone will make a cure possible. It is from this point of view that we must address ourselves to the problem.

There are four aspects of the subject: First, what is meant by separation of state and local revenues? Second, what are its disadvantages? Third, what are its history and development? And fourth, what are the dangers of the system?

I. In the first place, separation denotes, as the word implies, some distinction between the classes of revenue. Almost everywhere in the United States the general property of individuals is assessed for local purposes, and as corporations developed, their property was also assessed in the same way by local assessors. County expenses are usually defrayed by apportioning the necessary amount to the localities according to the assessed valuation of property and thus adding a county rate to the local rate. Finally, the state expenditures are defrayed in precisely the same way by dividing up among the separate counties a sum proportioned to the assessed valuation in the counties. Thus the final tax rate upon property is made up of the addition of these various rates. But the assessment and the collection are for the most part in the hands of local authorities.

What will be gained by the separation of state and local revenues is that the state revenues will no longer be collected from the same source and in the same manner as the local revenues. It means practically that there should be no state tax rate on general property added to the local tax rate through the process of apportioning state expenditures among the localities according to the assessed valuation. And it implies as a corollary that some other method of securing the state revenues be

devised. The demand for separation is primarily a negative rather than a positive one; it is destructive rather than constructive. It claims that the root of the present evil must at all costs be pulled out. It leaves open for debate what particular alternative methods should be substituted. It proclaims in no uncertain tones, "Leave to the locality what properly belongs to the locality; allot to the State what properly belongs to the State."

II. The second aspect of the problem is a discussion of the advantages that would ensue from separation. These may be summed up under the following heads: *A.* Conformity with the natural division of government functions and activities. *B.* Greater equality in assessments. *C.* Lowering of the tax rates. *D.* Removal of conflicts between city and county. *E.* Greater flexibility and adaptation of means to end.

*A.* The first advantage is the conformity with the natural division of government functions and activities. The relation of government to business life necessarily changes with the conditions of business activity. When business was purely local in character, as was true in former times, the local authorities were competent to deal with them. To-day yet, activities connected with real estate are still largely of this character. The real estate cannot be removed from the locality, and the benefits and burdens attaching to real estate are still to a very large extent bound up with the people who live in the immediate neighborhood. What is true of real estate was originally true of almost all economic phenomena. But it is no longer true. The scope of the great industries connected with the transportation of wealth and the transmission of power or intelligence is obviously no longer local in character, and many of the ordinary corporations and businesses are stretching out with an activity that transcends all local bounds. While the central office must indeed be in some one locality, the scope and content of the activities are no longer local, and in the great majority of cases any attempt to estimate the economic capacity of the business or corporation to bear the tax burdens by the property existing in that locality would be woefully inaccurate. Not only would the local property often be in no proportion at all to the local sales, but even the local sales would

not be any index of the relative profits or tax-paying ability. The insurance company (although situated with its head office in some one town) does business throughout the entire State; the railroad may have four tracks in a little country village which contributes practically nothing to the traffic; a bank may derive its profits in large measure from out-of-town business. Where the activity is primarily interlocal or state, the burden should be interlocal or state.

Not only, however, is there this natural division between state and local functions, but even where the phenomenon itself is purely local, experience has disclosed in some cases the great advantage of assessment by state rather than by local officials. Real estate, for instance, can far better be valued by officials of the neighborhood who are cognizant of the local conditions. But the administration of a liquor license law is apt to be far more effective if divorced from local influences. It is for such a reason, for instance, that the liquor-license tax is now levied in New York by state officials with a far greater degree of efficiency and therefore with a far greater resultant revenue than was formerly the case. So also certain taxes are more effective when resting on a broad than on a narrow basis of assessment. The inheritance tax, for example, is obviously unfit for a source of local revenue because the number of wealthy individuals who die in any one year in a single town or city is so unpredictable and oscillating that the revenue would be entirely too spasmodic. Broaden the base by taking in the whole State, and the amount of property passing by death from year to year will be found to fluctuate very little.

Thus, from the double point of view of historic changes in the scope of government functions and in the effectiveness of administration, a clear line can often be drawn between what is properly a state and what is properly a local source of revenue.

This consideration really carries one step farther a distinction which is found almost from the beginning of our national existence. At first, there was no line drawn between national and state sources of revenue, and in the critical years succeeding the Revolution the Union had to depend upon requisitions addressed to the separate States to be raised by them in the

same way as their own local revenues. With the collapse of this system was settled once and for all the principle of a separate and independent national revenue from sources, in part at least, distinct from those of state revenue. The whole domain of foreign commerce, which up to that time had been within the purview of the separate States, was now transferred to the Union, and the force of historical necessity has since then converted certain forms of internal taxation, which were still for a long time administered by the separate States, to the practically exclusive possession of the Union. The process is not indeed entirely complete, and we are even now debating whether certain forms of state taxation should not hereafter be relegated to the general government. The point which it is desired here to emphasize, however, is that the principle has been settled. It is the same principle which is now applicable to the separation of revenues within the State. It was the financial collapse of the Confederacy which brought about the separation of national and state revenues. It is the practical collapse of our antiquated fiscal system within the States which is just beginning to bring about the separation of state and local revenues. The change in the economic conditions at the end of the eighteenth century was responsible for the one; the change in the economic conditions at the beginning of the twentieth century will be responsible for the other. Thus, the first advantages of the separation of state and local revenues is the fact that it is in harmony with an underlying principle of historical growth.

*B.* The second advantage is the securing of greater equality in assessments. The differences in assessed valuations in various sections of our States have everywhere become so glaring that the last few decades have seen in almost every case the creation of boards of equalization designed to remedy the acknowledged evil. It is equally notorious, however, that the remedy has been entirely inadequate and that the boards of equalization have been unable to accomplish what was expected of them. The inequalities go on almost unchecked, very largely for the reason that the members of the state boards have too imperfect a knowledge of the local conditions to admit of any successful revision of property valuations.



The relegation of the general property tax to the localities will at once render unnecessary any equalization, for if the state revenues are secured in other ways, and if the general property of individuals, whether real estate or personalty, is not directly liable for state purposes, there will of course be no inducement for the local authorities to seek to lower the local valuations of property. For purely local purposes it makes no difference whether there is a low valuation with a high tax rate or a high valuation with a low tax rate; the result is precisely the same. With the separation of state and local revenues the individual landowner in one part of the State will no longer be casting envious glances at the landowners in other parts of the State, and this mad scramble for reduction of assessments will be checked. It will depend entirely upon the people in the community itself, and not upon those in other communities, whether the individual tax rate shall be high or low.

C. This brings us to the third advantage, the political aspect of which is not slight. Where, as at present in some cases, the state taxes form no inconsiderable part of the whole, the tax rate upon the individual property owner is naturally augmented to this extent. Under a system of separation of state and local revenues, with a relegation of the property tax to the localities, the rate of the tax will naturally be lowered by the entire amount of the state revenue previously derived from this source. In the development of the system in New York, for instance, this argument had great weight with the legislators and was largely responsible for achieving the final result. The separation of state and local revenue means a reduction of direct taxation of property.

D. The fourth advantage is the removal of conflicts between city and county. The present situation in many of our States is really an outgrowth of point *B* mentioned above; namely, the inequality in the assessments of property. Many of the rural counties claim that since there is a far larger proportion of tangible and visible property within their borders than is the case in the larger cities, the property actually assessed in their case greatly transcends in its relative proportions the property assessed in the cities. There is, therefore, a frequent

pressure upon boards of equalization to raise the total valuations in the cities and to compensate for this by reducing the valuations of the rural districts. In a State like New York, for instance, there was an almost annual contest marked by bitterness and asperity, leading in some cases to the threat on the part of the city of New York that an attempt would be made to create a separate State. The separation of state and local revenues puts with one blow an end to all these sources of difficulty and friction. The large city as well as the small town, each is allowed to go its way in peace.

*E.* The final advantage is virtually a corollary of the one just discussed; namely, a greater flexibility and adaptation of means to end. If each locality is now, through the separation of state and local revenues, divorced from the others and is left to work out its fiscal salvation, to a certain extent at least, independently, it is obvious that each locality will be better able to adjust its fiscal system to its own particular fiscal needs. The conditions of a commercial metropolis are very different from those of a country hamlet, and what may be entirely appropriate in the second case may be found to be completely unworkable in the first. The slow steed and the fleet pacer work very ill together in harness: set each of them free to do what he can and the total result will be far more satisfactory for all concerned. Uniformity of fiscal methods is desirable only where there is a uniformity of economic conditions. If we allow the different localities to experiment, within certain broad lines, as to the fiscal methods best suited to their own prosperity, the result is ultimately bound to be an adaptation of fiscal practice to economic fact.

Thus from each of these five points of view the benefits which would accrue from a separation of state and local revenues are clear and undeniable. But so strong is the force of custom and prejudice, and so inadequate is the ordinary analysis made of the situation, that the movement has really only just begun in the United States.

III. We come then, in the third place, to a word as to the history of the separation of state and local revenues.

The separation of state and local revenues in the sense of abandonment of the general property tax for state purposes



has been achieved in only one important commonwealth, New York. In several States, indeed, a beginning has been made by securing for state purposes a supplementary revenue over and above that from the general property tax. But this partial achievement virtually secures none of the advantages of a complete separation except possibly that of a moderate reduction in the tax rate. It is valuable only as affording a basis on which to erect the complete structure of an independent state revenue. Again, in a few of the smaller Eastern States, like New Jersey, Connecticut and Delaware, where the state expenses are relatively slight, it has been found practicable to defray the state expenses primarily from taxes on corporations. But even here the separation of state from local revenue is ostensible rather than real because as in New Jersey the school taxes, which do not figure in the state budget, are divided by the State in proportion to local valuations on property, thus virtually continuing all the disadvantages of a state assessment or a state equalization. Pennsylvania has almost reached the goal by discontinuing any state taxation of real property, but Pennsylvania still enforces the state tax upon personalty, even though this be done in a somewhat peculiar way. New York is the real example of separation of state and local revenues, although from the local point of view the separation is not complete because corporations are still nominally subject to the general property tax for local purposes. So far, however, as the chief point is concerned, namely, the abandonment of the general property tax for state purposes, New York has in practice reached the separation of state and local revenues.

This has been accomplished only within a year or two. The creation of an additional and supplementary source of state revenue over and above that from the general property tax began almost a quarter of a century ago, but it was not until about a decade later that the author of this paper was fortunate enough in impressing upon the authorities the importance of a system of complete separation. Ever since that time the process has gone slowly forward, until in 1906 the last step was taken and provision was made for securing the entire state revenue — between thirty and forty millions of dollars — from

other sources than the general property tax. The separation, however, is not yet enforced by any specific law; it is simply the result of annual legislative decision. In New York, therefore, we stand on the threshold of a far more important movement. We have cleared the way and are ready to begin our onward march. What has been accomplished in New York is certainly not impossible of accomplishment elsewhere.

IV. It may be inquired, however, in the last place, are there no objections to the system of separation or are there no dangers connected with it? A candid consideration would compel an answer in the affirmative, but a closer scrutiny will result, I think, in the conclusion that the objections are largely specious, and that the dangers are at least remediable.

What are its objections and dangers? They may be summed up under three heads: a lack of suitable state revenues; a lack of elasticity; a lack of suitable local revenues. Let us consider these in turn.

It might be claimed by some States that if the general property tax is abandoned as a source of state revenue, there is nothing to put in its place. The experience of the more advanced States, however, shows the fallacy of this contention. Even where the ordinary business corporations have not assumed vast proportions, we find in all the States the existence of the great public service corporations. Under a proper system of assessment, the tax on corporations of this kind, if reserved primarily for the State, would go far toward defraying all legitimate state expenses. The difficulty now is that in many of our States the greater part of the taxes on corporations go to the localities, where, as we shall see in a moment, they are not needed, and only a small part, if any, is assigned to the State. If we render to Cæsar what belongs to Cæsar, the tax on corporations will go primarily to the States. Another source of state revenue which is now spreading in this country, but which has by no means received the development of which it is susceptible, is the inheritance tax. In New York over one sixth of the entire state revenue is secured from this source, and the same is true in many foreign countries. Owing to defects in the principle as well as in the administration of the law, the inheritance tax in many other

States is very ineffective. But New York again has shown the way. Where corporations and inheritance taxes do not suffice, other sources of revenue stand ready at hand. There is no reason, as we have seen above, why the license taxes should be reserved exclusively for local purposes. In the Southern States the license or occupation taxes have for a long time gone, in part at least, to the State, although the whole Southern system is capable of much improvement in this and other respects. Here, again, in New York, it has been shown what can be done, and about one third of the entire state revenue comes from the liquor license tax alone. In short, without going more in detail into this question, which is susceptible of a far larger treatment, it may be said that there is scarcely a State in this Union where, under proper methods, adequate sources of state revenues could not be discovered and effectively employed. But even if this were not the case, and if it turned out to be difficult to secure additional sources of state revenue, there is still left a simple and efficacious means of accomplishing all the advantages that can be derived from separation, without incurring the hazard of not finding sufficient state revenues. This method may be called the apportionment-by-expenditure method.

The apportionment-by-expenditure method may be described as follows: At present the state general property tax is distributed among the counties by apportioning the quota of each according to the assessed valuation of property. The apportionment-by-expenditure method as opposed to the apportionment-by-valuation method would distribute the amount to be raised for state purposes to each county on the basis of the total expenditure or, what is the same thing, on the basis of the total revenues collected to defray this expenditure within each county and all the taxing districts contained in the county. The advantages of this scheme are obvious.

First and foremost, it would permit each locality to raise its revenues as it chose within certain broad lines, as laid down by the general law. The apportionment being no longer according to the valuation of property in general, but according to expenditures or revenues, it would be immaterial to any section in the State how the local revenues of any other sec-

tion were raised. The important point would be the extent of the revenue and not the manner of raising it.

It was mainly to secure at once local option in the selection of the subjects of taxation that the apportionment-by-expenditure method was urged by Mr. Lawson Purdy, who first suggested this scheme several years ago.<sup>1</sup> This designation of local option is perhaps not entirely happy in that it does not adequately describe the powers to be conferred upon local communities. Moreover, the term "local option" has become so intimately associated with the liquor problem that its utilization for taxation is apt to become confusing.

Secondly, even if the general property tax were retained for the basis of assessment by the localities, the apportionment-by-expenditure method would result in a more equitable distribution of the burden than is the case at present. For, as has been explained, it is notorious that assessments of personal property in the rural counties are almost inevitably higher when compared to actual values than is the case in the cities. On the other hand, expenditures or revenues correspond much more nearly to the actual taxable abilities of the communities. Hence, apportionment by expenditure would bring about a more equitable distribution of burdens than is the case at present. A careful computation that was made several years ago in New York when the board of equalization still apportioned the state tax shows that under this new system the counties which would pay more are either the rich counties which contain the most valuable land in the State, or the counties which received too high a percentage rating from the board of equalization.<sup>2</sup>

Thirdly, the apportionment-by-expenditure method would tend to economy in both state and local government. Local extravagance would, to a slight degree at least, increase the proportion of the state burden, and state extravagance would be directly reflected in a higher charge on the localities.

<sup>1</sup> "Local Option in Taxation," a paper read at the Buffalo National Tax Conference, May 23-25, 1901; also separately published by the New York Tax Reform Association. In this paper, however, Mr. Purdy is perhaps unduly critical of the other method of securing separation of state and local revenue.

<sup>2</sup> The figures are given in an appendix.



The fourth benefit is that the present state boards of equalization would be rendered entirely unnecessary, for the whole matter would be settled by a mere arithmetical computation which would leave no room either for favoritism or for unintentional injustice.

Finally, fifthly, since it would be necessary to have full figures of statistics and revenues of all counties and local divisions, we should secure at once a system of comparative local statistics which have hitherto been almost entirely wanting in most of the States, and the lack of which is a serious obstacle to fiscal form.

The chief objection to this scheme of apportionment by expenditure is that it might tend unduly to prevent desirable expenditures in the more progressive communities. The force of this objection is, however, not so great as it seems. For, in the first place, if the community is ready to subject itself to the burdens of a larger expenditure for desirable aims, it will scarcely be checked by the very slight additional burden which would result from the increase of the state tax. For the local burden is always very much greater than the state burden. Secondly, even if this were not true, the force of the objection could be very largely attenuated by combining the apportionment-by-expenditure method with the system above described of an independent state revenue from other sources than property. If this were done, that is, if the greater part of state revenues were derived from independent taxes, and if only the necessary residuum were raised by the apportionment-by-expenditure method, the proportion falling to each locality would be so exceedingly slight as virtually to rob the objection of whatever strength it might be supposed to possess.

It is interesting to observe that the apportionment-by-expenditure method has been introduced into one State, namely, Oregon. The Oregon law of 1901 adopted the scheme, however, only in part, in that it apportioned the state property tax to the counties for the first few years according to a table of fixed percentages based on valuations. According to the new law of 1907, the system of apportioning taxes according to expenditures is to go into effect in 1912. In Oregon, however,

there are two points in which we find a departure from the principles of the system. The first is that the apportionment is not to be made according to all expenditures, but only according to some expenditures, — expenditures for roads, for interest on the debt, for courthouses and for fighting pestilence being deducted in each case. More important than this, however, is the adoption of the rule that the apportionment itself is to be made according to county expenses instead of according to the total expenses of all the localities within the county as well as of the county itself. While something perhaps may be said for the first derogation from the principle, it is difficult to see the justification for the second. For in this way the apportionment-by-expenditure method is robbed of many of its advantages. Even this partial adoption, however, of the system secures for Oregon the great object which was to be attained; namely, the separation of state and local revenues. It must also be remembered that Oregon joins to the apportionment-by-expenditure method that of independent state revenues by special taxes.

Thus we see that the contention that separation of state and local revenues is impossible in some States, because of a lack of adequate state revenues, is weakened, if not entirely overcome, by the adoption, in part at least, of the alternative method to be employed in one of the least developed of our commonwealths. It must, however, not be supposed that the principle of separation of state and local revenue is conditioned by the acceptance of the apportionment-by-expenditure method. If this method should on the whole prove to be unwise or inexpedient, the separation of state and local revenue would not be affected thereby. The separation of state and local revenue does not necessarily imply either complete local option or any specific method of apportionment. These do not stand or fall together.

The second possible objection to the scheme of separation is the lack of elasticity in state revenues. Whatever are the drawbacks of the general property tax for state purposes, it is undeniable that the system is a highly elastic one. When the State needs more revenue, it simply increases the tax rate; when it needs less revenue, it diminishes the tax rate. By



abandoning the general property tax for state purposes, we therefore lose this necessary element in the system.

There are, however, three ways of reintroducing the elasticity which will be lost. The one obvious and simple method is to utilize as the elastic feature the apportionment-by-expenditure method just described. If any more money is needed in any one year, so much more can be apportioned to the counties. Secondly, in default of the adoption of this method, the elasticity lost by the abandonment of the general property tax for state purposes might be regained by introducing a varying rate in one of the other taxes. There is no necessary reason why the tax rate should always be the same from year to year. In the case of taxes on business or on corporations, indeed, it would be highly inadvisable to alter the rates from year to year as tending to unsettle business. But to other forms of taxation this objection would not apply. England secures elasticity by varying the rate of the income tax from year to year. There is no reason why in the American States the rate on the inheritance tax should not be modified from time to time so as to secure a slightly greater or slightly smaller revenue. The change in the tax rate on inheritances cannot very well bring about a change in the death rate of the people whose property is inherited. And thirdly, even if neither of the above schemes approves itself to the community, we might adopt the suggestion which has been made in the recent report of the New York State Tax Commission; namely, that the State should accumulate a small surplus which it would hold to meet any possible deficit, and that when the surplus exceeded a certain figure, it should be automatically returned to the localities for the relief of local taxation.

In any one of these three ways elasticity could surely be secured.

The third and final objection to the separation of state and local revenues is that the localities cannot afford to relinquish to the State any sources of revenue which they now possess. It is claimed, for instance, that many of the rural counties which now secure a large revenue from the property tax on the property of the transportation companies which happen to traverse them cannot afford to lose this revenue.

We here come to a point which has been much neglected in the discussion of the subject; namely, an insufficient analysis of what is really implied in the separation of state and local revenues.

As I conceive it, there are two kinds of separation which might be termed respectively the segregation of source and the division of yield. The segregation of source means that an entirely different source of revenue should be utilized for state purposes from that which is used for local purposes. It is this which is meant when we say that the State should no longer derive its revenue from the source of the general property tax. But there is an entirely different method of attaining the same result; namely, by the exclusive state assessment of certain sources of revenue coupled, however, with an apportionment of a part of the proceeds to the localities. For instance, the inheritance tax ought to be levied by the State and not by the locality; therefore there would be here a segregation of source in the assessment. There is, however, no reason why, after the tax has been collected, a part of the proceeds should not be apportioned to the localities. The corporation tax ought indeed to be levied independently by the State, and here again there is no reason why a portion of the proceeds should not be distributed to the localities. The excise tax in New York is admirably administered by the state officials, yet one half of the proceeds is returned to the localities. The division of yield of a tax is perfectly compatible with a segregation of the source of a tax. The trouble with our present system is that we attempt to make a local assessment of all property and then add something for the State, thus producing all the evils of the actual situation. What should be done, and what is beginning to be done in some places, is to leave the property tax on individuals entirely to the local divisions and to develop a system of taxation assessed in first instance by the State, but with an apportionment among the localities of so much of the proceeds as may be necessary. We must not confuse segregation of source with division of yield. If we establish a separate system of state taxes, that is, a tax levied and assessed in first instance by the State, and if we then find, as can easily be accomplished, that the revenue is more

than adequate for state purposes, it is an exceedingly simple matter to arrange for a distribution of the overplus among the localities.

As stated earlier in this paper, the difficulty is not with the social income as a whole. There is in the community an abundance of wealth which has never been tapped. The difficulty lies in the present method of apportioning the burden. By raising local revenues primarily from those sources which exist in abundance in the localities, and which are by nature local in character, and by retaining for state assessment those taxes which have a wider economic basis, we can be just to all demands of both State and locality without imperiling the fiscal situation in either, and at the same time securing a freedom from all the difficulties that beset us at present. The separation of state and local revenues includes two distinct phases, the segregation of the source of revenue and the division of yield of the tax. The real principle is to reserve a direct taxation of property for the localities and to hand over to the State all the important sources of revenue, dividing a part of the proceeds among the localities and possibly making up any part of the deficiency for the State through the system of apportionment by expenditure. In this way we may secure all the advantages of separation of state and local revenue, and yet avoid the dangers and pitfalls.

It will be seen from the above presentation that separation of state and local revenue is by no means identical with what is sometimes called local option in taxation — a term in itself unfortunate for reasons that have been mentioned above. Separation does, indeed, involve some measure of choice by the localities, and that is, in fact, one of its great advantages; but local option may obviously be carried to an extreme. The liberty of taxation on the part of separate local communities must not be permitted to disrupt the general scheme of taxation, or to imperil business activities through a rivalry in the application of the taxing power. What has been so laboriously gained in state taxation through the intervention of the national authority, which prohibits the state taxation of interstate commerce, must not be lost in local taxation through the absence of state control. What the separation of state and local revenue

seeks to accomplish is, as we shall see below, to make it possible for localities ultimately to exempt personal property from taxation. So far as a flexibility of local revenue may render this possible, it is desirable to grant to the locality, at least to this extent, a latitude of exemption. But this is far from being synonymous with a general demand for complete local option. That is a proposition which deserves discussion on its own merits, and to which valid arguments may undoubtedly be opposed. Let us not endanger the attainment of the principle of separation by confounding it with a far more radical system of complete local option.

### III

There remains a word to be said about the ultimate outcome of the process of which the separation of state and local revenue is only the first step. To discuss this as it deserves to be discussed would need a separate paper. All that I shall here attempt is to give a faint indication of the probable development.

In a primitive democratic community, the simplest way to reach the taxable ability of the individual is through his property. The general property tax is a satisfactory index of relative taxable faculty because the property is homogeneous. To tax the individual and to tax the property of the individual is virtually the same thing. But in modern times property is no longer homogeneous. With the development of commerce and industry on a vast scale, property splits up into all sorts of forms and the old homogeneity disappears. It becomes practically impossible to reach all forms of property equally. But as soon as it becomes in practice, as it does everywhere, an uneven tax, the social consequences of taxation make themselves felt. The taxation of certain kinds of property is no longer the taxation of the individual who owns the property. He may pay the tax, but he no longer bears the tax. The vast economic forces which affect the property relations of class to class make themselves felt. Some taxes are shifted onward to other classes, and are, perhaps, ultimately diffused throughout the community. Some taxes are shifted backward to the original owner and through the process of capitalization



are discounted by the new purchaser of the property. Thus, while some taxes remain on the owner, others finally disappear entirely as a burden through a process of diffusion or absorption. A tax on mortgages, as is now well understood, does not remain on the lender of the money, but is shifted to the borrower, and where the borrower is a building operator, it affects the dwellings and ultimately the rentals with various incidental consequences all the way along. A tax on city lands is not borne by the man who has purchased the land after the tax is imposed, because he makes allowance for the tax in the purchase price of the land. The same is true of the purchaser of corporate or government bonds. A tax on the stock-in-trade of a merchant or factory-owner, if predictable and applied to all the members of a class, results in an increased price of that commodity to the consumer. No constitutional provision can be of avail against the overpowering force of economic pressure. We may, like Cnut, order the waves to recede, but they will not recede. The constitutional provision in most of our States, that all property should be taxed alike, has outlived its usefulness. You cannot tax all property alike, because it is humanly impossible under modern conditions to reach all property alike; and if you do reach all property alike, the modern social effects of taxation are such that you would not be putting an equal burden upon the property owners because you would then be hitting the wrong man. Until we recognize the fact that under modern conditions to tax the property is not, in many cases, to reach the owner of the property, no solution of the problem can be attained.

The separation of state and local revenue is, therefore, of such fundamental importance because it will allow every community to approach the problem in an unbiased way, and will enable them to select those classes of property which could profitably be relinquished. It means practically that those communities which choose to abandon the personal methods of taxation and to substitute an impersonal taxation may be permitted to do so.

The two questions that will naturally present themselves here, however, are: first, how will great wealth be made to bear its share, and second, how is the burden on the farmer to be

lightened. As to the first point, it may perhaps be queried whether a better way of reaching great wealth is not by curtailing the special privileges which so often make great wealth possible. Without, however, developing this point here, it may be affirmed that if we desire to reach the results rather than the sources of great wealth, a method stands ready at hand. By developing the inheritance tax we shall accomplish all the advantages of a personal taxation without any of its drawbacks. A state income tax would, under our actual American conditions, not work a whit better than the discredited personal property tax, and the only possible resort to it would be under the ægis of the national government. With the corporation tax and the inheritance tax we shall go far toward reaching the main elements of modern fortunes. The difficulties here, indeed, arising from the conflicts of state jurisdiction are great, but not insuperable. They will be overcome either by the development of a system of interstate comity, or perhaps by a further development of the principle of division of yield, whereby the taxes will be assessed in first instance on a uniform basis by the federal government and then apportioned according to constitutional methods among the States.

The second problem is that of the farmer. If the local tax is primarily on real estate, and if, as frequently happens, the conditions of production are such that the farmer is unable to shift the burden of the tax to the consumer, what can be done? Here a double avenue of escape is open. In the first place, many of the expenditures of local communities ought to be defrayed by the state government. Even now, in several of our commonwealths, state roads are being constructed throughout the local divisions because transportation is being recognized as affecting the interests of the whole State. But if certain roads ought to be state roads, and constructed at state expense, why should not certain schools be state schools and conducted at state expense? Education, like transportation, is more than a merely local matter.

In the second place, while the expenditure side may be cut down in this way, the revenue side may be augmented by an application of the principle of the division of yield whereby the overplus of certain state taxes like the excise tax or the



corporation tax or the inheritance tax is distributed among the localities. Thus the burden on the local real estate will be decreased rather than augmented. Under the present system the farmer pays not only his own taxes, but in large part the taxes of the rich men of the rest of the State. Under the new system of separation of state and local revenue, carried to its logical conclusion, the farmer will pay less and get more; and what is true of the farmer is true of other classes. The tax burden will be shifted from the individual to the economic phenomena themselves.

The problems of taxation in the United States are becoming every year more complex. In order to solve them we must keep in mind the ultimate goal, and be prepared to take the first step. The ultimate goal is the accommodation of fiscal methods to our changed economic conditions. The first step is the separation of state and local revenues.

APPENDIX <sup>1</sup>

*Apportionment of state taxes in the State of New York on the basis of local expenditure or revenue, compared with apportionment on the basis of the equalized assessment of real and personal property.*

Accompanying this memorandum there are two tables, one of which shows the percentage of state taxes charged to each county of the State of New York in 1902, based on the equalized assessment of real estate and the assessment of personal property. The table also shows the percentage of state tax which each county would have been required to pay if the state tax had been apportioned on the basis of the local revenue in 1902, reported by the State Board of Tax Commissioners in their report for 1903. This report is incomplete in that highway taxes are omitted from the reports of towns. This affects the revenue of counties containing no cities more than the revenue of counties which contain cities, as the tax for streets is contained in the total revenue of cities. In the strictly rural counties the highway tax amounts to from 7 per cent to 12 per cent of the total revenue. The percentage of state tax paid by rural counties is so small that the omission of highway taxes affects the percentage very little.

Comparison of the percentage columns shows that the counties containing large and progressive cities, in fact the three richest counties outside the city of New York (Erie, Monroe, and Westchester), and the city of New York itself, would pay a larger share of the state tax if this share were determined by an apportionment on local revenue.

All the other counties which suffer an increase are described in the second table, with the exception of Oneida, Rockland and Saratoga; for Oneida and Saratoga the increase is very slight. Oneida contains prosperous cities, and Saratoga is a great summer watering place; both are prosperous counties. Rock-

<sup>1</sup> Prepared by the New York Tax Reform Association, of which Mr. Lawson Purdy was at the time secretary.

land is a suburban county which to some extent reflects the prosperity of New York.

In the second table a comparison is made between counties whose proportion is decreased and counties which suffer an increase, and so far as possible counties of similar character and nearly equal population are grouped together. For the purpose of comparing the wealth of the counties, the table shows the area in acres, the population in 1900, the "special franchise" assessment, the real estate assessment, and the percentage of full value with which the assessment of the county is credited by the State Board of Equalization.

The special franchise assessment is made by the State Board of Tax Commissioners. It is the assessed value of the property of public service corporations in streets and public places together with the value of the right, privilege or franchise to maintain and operate it there. The value of special franchises is an indication of the density of population and reflects the value of land bordering the public streets. Where the value of land is low, a franchise is not valuable; where franchises are very valuable, the land bordering the highways is valuable.

In the first group it will be noticed that the proportion to be paid by Chautauqua County is increased, and that it is credited with a very high percentage of assessed value. Tried by every test, this percentage seems considerably too high. The value of real estate in Chautauqua is evidently much more than in Jefferson County, and much more than the assessment indicates. Ulster County has land of high value because within it is situated some of the most beautiful scenery of the Catskill Mountains, and it is visited in the summer by many thousands of wealthy people.

In the next group Clinton County is a remarkable example of underassessment, and the percentage rating of 50 per cent is readily seen to be too high when Clinton is compared with Chenango, Greene, and Livingston or with any other county of similar character. Essex and Franklin both have many acres of timber land, especially Essex, which is obviously under-assessed.

Hamilton County stands by itself as a peculiar county. It is narrow and very long, most of it in the Adirondacks.

In Hamilton County there are the summer homes of many wealthy men who own large tracts of forest land. The assessment is low.

In the next group, Schoharie is one of the poorest counties of the State in proportion to its population, yet its assessment is high as compared with many others in the table. Sullivan County is obviously given too high a rating. It has more than double the population of Putnam County, almost three times its franchise value and the assessment is about two thirds. Putnam is a farming county just as Sullivan is.

In the next group, Madison and Washington are farming counties, while Herkimer and Schenectady have considerable manufacturing cities.

In the last group, Dutchess and Orange are farming counties, and Suffolk is unique. It comprises the easterly two thirds of Long Island. It is very poor for ordinary farming purposes, but the north and south shores are becoming valuable for summer homes.

Niagara County has the power of Niagara Falls, is developing great manufacturing establishments, and there is no doubt that the power privileges are greatly underassessed and that the assessment as a rule is not high enough to justify the rating of the State Board of Equalization.

These comparisons show that the counties which would pay more if the state tax were apportioned on local revenue are either rich counties which contain the most valuable land in the State, or are counties which receive too high a percentage rating from the Board of Equalization. The counties which would pay less are poor counties with land of low value, or counties which do not receive the percentage rating to which they are entitled.

Statement showing percentage of state tax actually paid by each county of the State of New York in 1902, on the basis of equalized assessments, and percentage which each county would have been required to pay if the state tax had been apportioned on the basis of local expenditure or revenue.

	PERCENTAGE PAID ON EQUALIZED ASSESSMENTS	PERCENTAGE IF APPORTIONED
Albany . . . . .	1.517	1.486
Allegheny . . . . .	.252	.206
Broome . . . . .	.571	.495
Cattaraugus . . . . .	.404	.333
Cayuga . . . . .	.562	.454
-Chautauqua . . . . .	.548	.595-
Chemung . . . . .	.436	.397
Chenango . . . . .	.272	.205
-Clinton . . . . .	.160	.213-
Columbia . . . . .	.409	.328
Cortland . . . . .	.204	.168
Delaware . . . . .	.248	.237
Dutchess . . . . .	.754	.549
-Erie . . . . .	5.246	6.120-
-Essex . . . . .	.171	.176-
-Franklin . . . . .	.186	.201-
Fulton . . . . .	.250	.246
Genesee . . . . .	.400	.185
Greene . . . . .	.220	.189
-Hamilton . . . . .	.050	.070-
-Herkimer . . . . .	.357	.365-
Jefferson . . . . .	.561	.522
Lewis . . . . .	.163	.115
Livingston . . . . .	.443	.181
Madison . . . . .	.348	.265
-Monroe . . . . .	2.370	2.710-
Montgomery . . . . .	.431	.368
Nassau . . . . .	.745	.461
-New York City . . . . .	66.431	68.107-

	PERCENTAGE PAID ON EQUALIZED ASSESSMENTS	PERCENTAGE IF APPORTIONED
-Niagara . . . . .	.684	.709-
-Oneida . . . . .	.974	1.076-
Onondaga . . . . .	1.803	1.796
Ontario . . . . .	.500	.287
Orange . . . . .	.726	.595
Orleans . . . . .	.259	.168
Oswego . . . . .	.457	.396
Otsego . . . . .	.359	.234
Putnam . . . . .	.124	.077
Rensselaer . . . . .	1.224	1.064
-Rockland . . . . .	.252	.294-
St. Lawrence . . . . .	.567	.359
-Saratoga . . . . .	.440	.449-
-Schenectady . . . . .	.360	.378-
Schoharie . . . . .	.187	.102
Schuyler . . . . .	.116	.071
Seneca . . . . .	.256	.153
Steuben . . . . .	.539	.428
Suffolk . . . . .	.757	.408
-Sullivan . . . . .	.101	.138-
Tioga . . . . .	.225	.171
Tompkins . . . . .	.274	.217
-Ulster . . . . .	.445	.565-
-Warren . . . . .	.130	.188-
Washington . . . . .	.310	.248
Wayne . . . . .	.440	.232
-Westchester . . . . .	2.620	3.017-
Wyoming . . . . .	.251	.159
Yates . . . . .	.181	.084
	100.000	100.000

Counties checked would pay more.



## STATE OF NEW YORK

Comparisons between some counties, showing in the first column the percentage of state tax paid in 1902, and in the second column the percentage which would have been paid if tax were apportioned on local revenue.

The two right-hand columns show the local assessed value of real estate, and the percentage of full value as estimated by the state board of equalization. The average percentage of full value for the entire State was estimated at 70+.

COUNTY	PRES. P.C.	NEW P.C.	AREA ACRES	POP. 1900	SPECIAL FRANCHISE ASSESS	REAL ESTATE ASSESS	EQUAL- IZED P.C.
Cayuga . .	.562	.454	415,629	66,000	\$588,320	\$31,719,000	.74
Jefferson . .	.561	.522	741,357	76,000	253,050	35,440,000	.83
Chautauqua . .	.548	.595	656,538	88,000	987,220	37,403,000	.90
Ulster . . .	.445	.565	663,331	88,422	290,690	26,293,827	.75
Chenango . .	.272	.205	548,035	36,500	127,000	14,756,889	.73
Greene . . .	.220	.189	372,850	31,500	97,500	12,137,988	.72
Livingston . .	.443	.181	384,300	37,000	120,690	23,752,499	.72
Clinton . . .	.160	.213	591,168	47,000	78,135	6,302,627	.50
Essex . . . .	.171	.176	1,152,188	30,000	77,000	10,352,776	.79
Franklin . . .	.186	.201	1,026,034	42,000	113,765	10,467,726	.74
Hamilton . .	.050	.070	1,086,683	5,000	52,500	3,588,356	.83
Lewis . . . .	.163	.115	778,147	27,000	34,260	9,197,452	.79
Putnam . . .	.124	.077	129,417	13,000	26,830	8,249,346	.77
Schoharie . .	.187	.102	372,111	26,854	54,340	10,782,865	.78
Sullivan . . .	.101	.138	603,897	32,000	71,000	5,822,178	.74
Warren . . .	.130	.188	498,672	30,000	134,000	7,909,807	.80
Madison . . .	.348	.265	374,334	40,000	130,825	17,990,160	.68
Washington . .	.310	.248	495,632	45,000	226,000	17,115,170	.75
Herkimer . .	.357	.365	895,282	51,000	377,580	24,403,514	.90
Schenectady . .	.360	.378	114,948	47,000	441,570	22,587,038	.70
Dutchess . . .	.754	.549	477,493	81,670	538,700	41,052,423	.72
Orange . . .	.726	.595	478,513	103,000	604,000	37,719,122	.68
Suffolk . . .	.757	.408	480,392	77,000	472,785	48,924,485	.80
Niagara . . .	.684	.709	294,527	75,000	1,100,000	44,619,834	.81

